No. 91-1513

IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

UNITED STATES DEPARTMENT OF THE TREASURY and MITCHELL A. LEVINE, ASSISTANT COMMISSIONER,
Petitioners,

v.

GEORGE FABE, SUPERINTENDENT OF INSURANCE, STATE OF OHIO,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

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BRIEF OF THE COUNCIL OF STATE GOVERNMENTS, NATIONAL CONFERENCE OF STATE LEGISLATURES, NATIONAL GOVERNORS' ASSOCIATION, INTERNATIONAL CITY/COUNTY MANAGEMENT ASSOCIATION, NATIONAL ASSOCIATION OF COUNTIES, U.S. CONFERENCE OF MAYORS, NATIONAL INSTITUTE OF MUNICIPAL LAW OFFICERS, AND NATIONAL LEAGUE OF CITIES AS *AMICI CURIAE* IN SUPPORT OF RESPONDENT

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QUESTION PRESENTED

Whether Ohio Rev. Code § 3903.42, which establishes the priority of claims in insurance company liquidations, regulates the "business of insurance" within the meaning of the McCarran-Ferguson Act, 15 U.S.C. § 1012.

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INTEREST OF THE *AMICI CURIAE*

Amici, organizations whose members include state, county and municipal governments and officials throughout the United States, have a compelling in-

terest in legal issues that affect state and local governments. This case presents a question of state regulatory authority of utmost importance to *amici:* whether carefully crafted state statutory schemes designed to protect policyholders in insurance company liquidations are to be subverted by the federal "superpriority" statute.

The importance of this issue to *amici* is demonstrated by the fact that more than twenty-five States have priority statutes that, like the Ohio statute here, place policyholder claims ahead of federal, state, and local government claims. *See* NAIC Model Regulation Service 555-39 - 555-42 (Jan. 1992). *See also* Br. *Am. Cur.* of National Association of Insurance Commissioners *Gordon v. United States*, No. 88-302 (U.S.) (brief filed Sept. 1988), Appendix D (collecting laws of 35 States that confer a higher priority on policyholder claims than federal government claims). The interests of millions of policyholders are directly at stake.

Because of the importance of this case to *amici* and their citizens, *amici* submit this brief to assist the Court in its resolution of the case.[1]

STATEMENT OF THE CASE

This case arises out of the liquidation of the American Druggists' Insurance Company pursuant to Chapter 3903 of the Ohio Revised Code. Section 3903.42 priorities claims in insurance company liquidations. It grants first and second priority to costs of administering the liquidation and salary claims of nonexecutive employees (limited to $1,000 per em-

[1] The parties' letters of consent have been filed with the Clerk pursuant to Rule 37.3 of the Court.

ployee). Ohio Rev. Code § 3903.42(A), (B). Following these traditional priorities[2]—which are necessary to fund the administration of the estate and provide limited compensation to employees—priority is then granted to "claims under policies for losses incurred." *Id.* § 3903.42(C). Ranked behind those are "[c]laims of general creditors," and behind general creditors are "[c]laims of the federal or any state or local government." *Id.* § 3903.42(D), (E).

In the ADIC liquidation, the United States filed over $10.7 million in claims based on immigration, appearance, performance and payment bonds and sought first priority under the federal superpriority statute, 31 U.S.C. § 3713(a)(1)(A). Pet. Br. 2. Thereafter, respondent George Fabe, Superintendent of Insurance of the State of Ohio, sought a declaratory judgment in federal district court that Ohio Rev. Code § 3903.42 is a regulation of the "business of insurance" under section 2 of the McCarran-Ferguson Act, 15 U.S.C. § 1012, and that the United States' claims were subject to the Ohio statute. The district court held that § 3903.42 does not regulate the "business of insurance" and that accordingly the federal superpriority statute preempted Ohio law. Pet. App. 44a-45a.

The court of appeals reversed. Relying principally on the three-factor test of *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119 (1982), the court held that Ohio's prioritization of the United States' claim was "a state regulation which protects the interests of the insured, and therefore is protected from federal preemption as a law regulating the 'business of in-

[2] *See* 11 U.S.C. § 507(a) (conferring favored priority on costs of administration and employee claims).

surance.'" Pet. App. 20a.[3] In the court of appeals' view, the Ohio statute satisfies the *Pireno* factors because it

> (1) transfers the policyholders risk of loss by insolvency at the time of contracting, (2) is an integral part of the relationship between insurer and insured, and (3) is exclusive in its operation to entities within the insurance industry.

Id. at 21a.[4]

SUMMARY OF ARGUMENT

The McCarran-Ferguson Act expressly preserves the "business of insurance" as a subject of state regulation. 15 U.S.C. § 1012(a). The Act provides that no general federal legislation "shall be construed to invalidate, impair or supersede any law enacted by any State for the purpose of regulating the business of insurance." 15 U.S.C. § 1012(b). Both the plain meaning of McCarran-Ferguson and the understanding of the enacting Congress demonstrate that Ohio Rev. Code § 3903.42 regulates the

[3] The parties have stipulated that the state priority provisions regulate the insurance industry, that application of the superpriority statute would "invalidate, impair, or supersede" the state provisions, and that the federal superpriority statute does not specifically relate to the business of insurance. Pet. App. 3a.

[4] The United States argued below that "even if the Ohio statute governs the priority of claims of the United States, the [federal] government's claims are entitled to third priority under the Ohio statute as policyholder's claims." Pet. Br. 11 n.4. This issue of state law was not addressed by the courts below, *id.*, and should not be addressed by this Court. *See EEOC v. FLRA*, ~~476~~ U.S. 19, 24 (1986); *Burford v. Sun Oil Co.*, 319 U.S. 315 (1943).

"business of insurance" and is not preempted by the federal superpriority statute.

A. The core of insurance is an undertaking by the insurer "to indemnify or guarantee another against loss by a certain specified contingency or peril." *Group Life & Health Ins. Co. v. Royal Drug Co.*, 440 U.S. 205, 211 n.7 (1979) (citation omitted). Obviously central to the "business of insurance" is payment of the insured's claim in the event such a loss occurs. "The key representation of the insurance company and the principal expectation of the policyholder is that prompt payment will be made when the event insured against actually occurs." *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119, 136 (1982) (Rehnquist, J., dissenting).

The purpose of state regulation of the "business of insurance" is to ensure that policyholders get what they bargained for. Ohio, like most States, has adopted a comprehensive regulatory scheme that preserves insurer solvency in order to protect policyholders. State regulation of the "business of insurance" does not end when an insurer becomes insolvent. The State's overriding purpose—the protection of policyholders—is no less great. Ohio Rev. Code § 3903.42 is thus an integral part of the State's comprehensive regulation of the "business of insurance."

B. This conclusion is underscored by the fact that at the time McCarran-Ferguson was enacted, the power of the States to regulate insurer insolvencies was long established. The regulation of insurance "has traditionally been under the control of the states." *SEC v. Variable Annuity Life Ins. Co.*, 359 U.S. 65, 69 (1959). Congress enacted McCarran-Ferguson to "broadly . . . give support to

the existing and future state systems for regulating and taxing the business of insurance." *SEC v. National Securities, Inc.*, 393 U.S. 453, 458 (1969) (citation omitted). Such state regulation was understood by Congress to encompass regulation of all aspects of "the relationship between the insurance company and the policyholder." *Id.* at 460. "The relationship between insurer and insured, the type of policy which could be issued, its *reliability*, interpretation, and *enforcement*—these were the core of the 'business of insurance'" as understood by Congress when it enacted McCarran-Ferguson. *Id.* (emphasis added). Ohio's grant of priority to the claims of policyholders epitomizes the State's concern for the "reliability" and "enforcement" of insurance policies.

C. Under this Court's analysis in *National Securities*, the Ohio statute regulates the "business of insurance" because it is an "attempt[] to secure the interests of those purchasing policies" and protects "the security of and service to be rendered to policyholders." 393 U.S. at 460, 462. The criteria advanced by this Court in construing the scope of McCarran-Ferguson's antitrust exemption in *Pireno* and *Royal Drug* are inapplicable here because they focus solely on the "business practices" of insurers, not on the expectations of policyholders. Both *Pireno* and *Royal Drug* recognize, however, that payment of policyholders' claims is at the "core of the 'business of insurance.'" *Pireno*, 458 U.S. at 128; *Royal Drug*, 440 U.S. at 215-16. The United States' reliance on these criteria ignores the fundamental purpose of insurance, the broad authority Congress gave the States to regulate the "business of insurance," and the limited scope of McCarran-Ferguson's antitrust exemption.

ARGUMENT

OHIO REV. CODE § 3903.42 REGULATES THE "BUSINESS OF INSURANCE" WITHIN THE MEANING OF THE McCARRAN-FERGUSON ACT.

A. Ohio's Policyholder Priority Statute Regulates the "Business of Insurance" in the Ordinary Sense of Those Words.

The McCarran-Ferguson Act provides that "[t]he business of insurance . . . shall be subject to the laws of the several States which relate to the regulation or taxation of such business," 15 U.S.C. § 1012(a), and that no general federal legislation "shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance." 15 U.S.C. § 1012(b). In order to determine whether Ohio Rev. Code § 3903.42 is saved from preemption by McCarran-Ferguson, the Court must decide whether it has "the purpose of regulating" the "business of insurance."

The answer to this inquiry is clear. The payment of policyholders' claims in the event of loss or injury is at the core of the "business of insurance." State regulation of the payment of claims in insolvency—including laws that establish favored priority for policyholders' claims—accordingly protects the fundamental interests of policyholders by ensuring that this core purpose of insurance is achieved.

1. *The "Business of Insurance" Is, Above All, the Business of Paying Insureds in the Event of Loss.*

"[T]he starting point in a case involving construction of the McCarran-Ferguson Act, like the starting point in any case involving the meaning of a statute, is the language of the statute itself." *Royal Drug*, 440 U.S. at 210. In this case the controlling language is "business of insurance."

The pertinent principles are well settled. An insurance contract is one "by which one party . . . promises to make a certain payment of money upon the destruction or injury of something in which the other party has an interest." 1 Couch on Insurance 2d § 1.2 at 4-5 (rev. ed. 1984). The insurance company, in other words, "undertakes to indemnify or guarantee another against loss by a certain specified contingency or peril." *Royal Drug*, 440 U.S. at 211 n.7 (citation omitted). *See* Black's Law Dictionary 802 (6th ed. 1990) (insurance is "[a] contract whereby, for a stipulated consideration, one party undertakes to compensate the other for loss on a specified subject by specified perils"); American Heritage Dictionary 667 (2d ed. 1982) (insurance is "[c]overage by a contract binding a party to indemnify another against specified loss in return for premiums paid"); Webster's New Collegiate Dictionary 600 (1977) (insurance is "coverage by contract whereby one party undertakes to indemnify or guarantee another against loss by a specified contingency or peril").[5]

[5] *See also Comm'r of Internal Revenue v. W.H. Luquire Burial Ass'n Co.*, 102 F.2d 89, 90 (5th Cir. 1939); *Cal. Physicians' Serv. v. Garrison*, 28 Cal. 2d 790, 172 P.2d 4, 13 (1946); *Benevolent Burial Ass'n v. Harrison*, 181 Ga. 230, 181 S.E. 829, 833 (1935); *People ex rel. Kasson v. Rose*, 174 Ill. 310, 51 N.E. 246, 246-47 (1898); *Aetna Ins. Co. v. Great Amer. Indem. Co.*, 124 So. 2d 626, 628 (La. App. 1960); *Associated Hosp. Serv. v. Mahoney*, 161 Me. 391, 213 A.2d 712, 721 (1965); *Chicago Bonding & Ins. Co. v. Oliner*, 139 Md. 408, 115 A. 592, 593 (1921); *Gregg v. Comm'r of Corporations and Taxation*, 315 Mass. 704, 54 N.E.2d 169, 172 (1944); *State ex rel. Duffy v. W. Auto Supply Co.*, 134 Ohio St. 163, 16 N.E.2d 256, 258 (1938); *Young v. Stephenson*, 82 Okla. 239, 200 P. 225, 227 (1921); *Nat'l Auto Serv. Corp. v. State*, 55 S.W.2d 209, 210-11 (Tex. Civ. App. 1932).

Central to the business of insurance is payment of claims in the event the losses insured against occur. "The key representation of the insurance company and the principal expectation of the policyholder is that prompt payment will be made when the event insured against actually occurs." *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119, 136 (1982) (Rehnquist, J., dissenting).

> "Up until the time there is a claim and a payment is made, the only tangible evidence of insurance is a piece of paper. In other words, *the real product of insurance is the claims proceeds.* Selection of the prospect, qualifying him for coverage that suits his needs, delivery of a policy, collecting premiums for perhaps years, making changes in coverage to meet changing situations, all of these are but preambles to *the one purpose for which the insurance was secured, namely to collect dollars if and when an unforeseen event takes place.*"

Id. at 136-37 (quoting J. Wickman, *Evaluating the Health Insurance Risk* 57 (1965)) (emphasis added). *See also* Butler, *Loss Adjustment in Fire Insurance, in* Property and Liability Insurance Handbook 219 (J. Long & D. Gregg eds. 1965) ("The adjustment (including payment) of claims represents the final

act in the insurance process. The payment of a claim by an insurance company brings the insurance contract 'to life' in a fashion far more vivid than does any other single act in connection with the purpose, issuance, and maintenance of the contract."), *quoted in Pireno*, 458 U.S. at 137 n.2 (Rehnquist, J., dissenting); C. Cissley, Claim Administration: Principles and Practices iii (1980) ("Claim administration is the last link in the process of insurance. . . . Indeed, it is the claim administration function that delivers on the product sold to the policyowner."), *quoted in Pireno*, 458 U.S. at 137 n.2 (Rehnquist, J., dissenting).[6]

2. *The Purpose of the Policyholder Priority Statute, and of the Regulatory Scheme of Which It Is a Part, Is to Make Certain Policyholders Are Paid.*

A. The primary purpose of state regulation of the "business of insurance" is to ensure that policyholders get what they bargained for: the insurer's payment on the policy in the event of loss. *See* Dingell Report at 1 ("An insurer's ability to pay—its solvency—must be subjected to proper regulation on a continuing basis, from the time premium payments are accepted until the time all anticipated insured events have occurred. The policyholder must rely on the

[6] As a recent, authoritative House report explains,

> When an insurer wrongfully fails to honor its promise to pay, the whole concept of insurance . . . fails. . . . The expectation that an insurance company will be around to pay legitimate claims is the first and most basic consumer right of every policyholder.

Staff of House Comm. on Energy and Commerce, 101st Cong., 2d Sess., *Failed Promises: Insurance Company Insolvencies* 1 (Comm. Print 1990) (hereinafter "Dingell Report").

competence of the regulatory system . . . for protection from insolvency.").

To accomplish this purpose, Ohio, like many States, *see NAIC Model Regulation Service* 555-39 - 555-42 (Jan. 1992), has adopted a comprehensive regulatory scheme designed to protect policyholders by empowering the superintendent of insurance to scrutinize closely insurers' finances on a continuing basis.[7]

[7] At the licensing stage, the Ohio superintendent of insurance has broad authority to examine the financial affairs of an insurer; if a license is issued, the superintendent must conduct audits every three to five years, and may conduct them more often if necessary. Ohio Rev. Code § 3901.07(B). All domestic insurers must meet minimum capital and surplus requirements. *Id.* §§ 3907.05 (life insurers), 3929.011 (other insurers). A licensed insurer that falls below state capital requirements may be prohibited "from issuing any new policies" as well as transacting any other business. *Id.* § 3901.10. Life insurers must deposit securities with the superintendent, who holds them "as security for policyholders in the company." *Id.* § 3907.07. All other companies are required to maintain minimum reserves in an amount "estimated to be sufficient to provide for the ultimate payment of all losses or claims, whether reported or unreported, for which the company may be liable." *Id.* § 3929.012. All insurers are required to file annual reports detailing their financial condition so that compliance with these requirements can be determined by state regulators. *Id.* §§ 3907.19, 3929.30. Only those insurers licensed in Ohio can sell policies within the State. *Id.* §§ 3905.01, 3905.42, 3909.01.

Certain transactions that might threaten an insurer's solvency are specifically regulated under the statutory scheme. Mergers or acquisitions of domestic insurers, for example, require approval by the superintendent, who must withhold that approval if he finds that "[t]he financial condition of any acquiring party is such as might jeopardize the financial stability of the domestic insurer, or prejudice the interests of policyholders." *Id.* § 3901.321(F)(1)(c). Transactions

As one commentator has explained, the emphasis of the regulatory scheme is

> placed simply upon protecting the little policyholder who cannot tell when he is charged too much for his insurance; since he does not investigate his purchase too carefully nor could he determine if a given insurer has the capacity, *i.e.*, the solvency, *to perform in the future when the insured event occurs*, the States have established regulatory bodies to secure that necessary measure of protection.

Richards, *Insurance* § 39 (emphasis added) (quoted in *Fabe*, 939 F.2d at 350).[8] The structure and scope

between insurers and their affiliates are also subject to the superintendent's approval, which he cannot give if the amount of the transaction exceeds a certain percentage of the insurer's assets or its "surplus as regards policyholders." *Id.* § 3901.341.

Permitted investments are set forth in the statutes in great detail, with the evident purpose of prohibiting overly speculative investments and restricting the amounts insurers may place at risk. *Id.* §§ 3907.14, 3925.05, 3925.09. Loans are similarly limited, and life insurers may not declare dividends without first setting aside "an amount equal to the reserve on all . . . outstanding risks and policies." *Id.* §§ 3907.14, 3907.18, 3925.05.

[8] The first state statute to prioritize claims in insurer liquidations, that enacted by Wisconsin in 1967, Wis. Stat. Ann. § 654.68 (West 1991), served as the paradigm for NAIC's Model Act, which in turn provides the model for Ohio's statute and those of many other States. *See* Spencer L. Kimball, *History and Development of the Law of State Insurer Insolvency Proceedings: An Overview*, in Law and Practice of Insurance Company Insolvency 9, 21 & n.37 (David M. Spector ed., 1986). In the committee notes included in the Wisconsin legislation and printed in the session laws, *see id.* at 25, the Wisconsin legislature explained why federal (as well

of Ohio's regulatory scheme demonstrates its primary purpose—to protect the expectation of policyholders that their claims will be paid.

For this reason, state regulation of the "business of insurance" does not abruptly end when the insurer becomes insolvent. As the Ohio scheme demonstrates, when an insurer is threatened with insolvency or actually becomes insolvent, the State's interest in protecting the expectations of policyholders is no less great. In these circumstances Ohio's statute provides

as state and local) government claims had been given a lower priority than the claims of policyholders:

> When an insurer must be liquidated, the outcome is often tragic. While many of the losers will merely be inconvenienced, others may suffer losses or delays in receiving payment that will subject them at least to hardship and may even deprive them of the necessities of life. It becomes apparent that claims that are socially more important need to be paid ahead of those that are less important. Recognition of such social equities is commonplace in the law relating to insolvency and bankruptcy.
>
> In an effort to minimize the harm done by liquidation, and especially to lessen it for those persons least able to bear it, much thought and consultation went into the structuring of the priority system. . . . There is no justification for giving a high priority to the sovereign because it is sovereign. On the merits, indeed, there seems an unanswerable case for declining to prefer government claims, including claims of taxes, and for giving priority to claims of greater social importance, such [as] the unearned premium reserve and, a fortiori, loss claims. The sovereign, and in particular the United States, will be able to survive without hardship even if relegated to the priority accorded ordinary creditors.

Wis. Stat. Ann. § 645.68 committee comment (West 1980) at 508, 512. *See also* Kimball, *supra*, at 33.

for active supervision by the State via three different levels of oversight.

First, the superintendent, upon finding "that [the] insurer is in such condition as to render the continuance of its business hazardous to the public or to holders of its policies or certificates of insurance," Ohio Rev. Code § 3903.09(B), may place the company under "supervision." *Id.* § 3903.09(C). Second, the superintendent may seek court approval to "rehabilitate" the insurer when, *inter alia*, "[t]he insurer is in such condition that the further transaction of business would be hazardous, financially, to its policyholders, creditors, or the public." *Id.* § 3903.12(A). An order of rehabilitation places the assets and management of the company in the hands of the superintendent, who is charged with doing whatever he "considers necessary or appropriate to reform and revitalize the insurer." *Id.* §§ 3903.13, 3903.14(B).

The greatest degree of state oversight occurs in the event of liquidation, which typically occurs only after an unsuccessful rehabilitation effort. *See* Howard, *Uncle Sam Versus the Insurance Commissioners: A Multi-Level Approach to Defining the "Business of Insurance" under the McCarran-Ferguson Act*, 25 Willamette L. Rev. 1, 9 (1989). In liquidation, the objective of the superintendent shifts from revitalizing the insurer to paying claims. Indeed, receiving and making determinations on claims is the superintendent's principal concern once a company enters liquidation. *See* Ohio Rev. Code §§ 3903.26-30, 3903.35-44.[9]

[9] The potential for federal disruption of orderly state administration of insolvencies based upon abusive assertions of first priority is virtually limitless. For example, in one recent

B. The United States, however, grossly mischaracterizes liquidation as a clean-up operation that occurs only after an insurer is no longer conducting the "business of insurance." According to the United States, Ohio's priority statute is not directed to the insurer but to the liquidator of its estate and "comes into play only when . . . [t]he only business being conducted is the liquidation of a corporation which happens to have been an insurance company." Pet. Br. 14 (quoting *Idaho ex rel. Soward v. U.S.*, 858 F.2d 445, 452 (9th Cir. 1988), *cert. denied*, 490 U.S. 1065 (1989)). This argument is untenable.

To be sure, once a company enters liquidation it is no longer an ongoing concern with the primary aim of generating profits. Yet in its ordinary meaning, the term "business" does not necessarily embrace profit-generating activity. Webster's New Collegiate Dictionary, for example, defines the term, *inter alia*, as "Role, Function," "an immediate task or objective." Certainly, the "function" and "immediate objective" of insurance is the payment of policyholders' claims. *See, e.g., Pireno*, 458 U.S. at 136 ("The key representation of the insurance company and the principal expectation of the policyholder is that prompt payment will be made when the event insured

case, the Resolution Trust Corporation filed claims totalling $7.5 *billion* alleging that the now insolvent insurer had been "a link in [a] junk bond 'daisy chain' that artificially inflated the price of junk bonds and indirectly led to the failure of about 50 thrifts." Kristof, *Settlement is Proposed on Failed Insurer*, L.A. Times, June 23, 1992, at D2. The liquidator settled the claims for approximately $5 million (less than one-one thousandth of the amount RTC sought) solely to avoid "years of litigation that could indefinitely stall rehabilitation of the failed insurer." *Id.*

against actually occurs.") (Rehnquist, J., dissenting); *Royal Drug*, 440 U.S. at 213 ("fundamental element[] of insurance is . . . the payment of a premium in exchange for a promise to indemnify the insured against losses upon the happening of a specified contingency"); *see also* authorities cited *supra* at 9-10. From the policyholder's perspective it is irrelevant whether his claim is paid by a functioning insurer engaged in profit-making activity or one in liquidation. *See Pireno*, 458 U.S. at 132 ("to the policyholder, . . . [the] only concern is *whether* his claim is paid, not *why* it is paid"). And in any case, it is "the 'business of insurance' and not the 'business of insurance companies'" which McCarran-Ferguson speaks to. *Id.* at 132 (quoting *Royal Drug*, 440 U.S. at 217).

Ohio's statute, like other state statutes that regulate the priority of claims, is thus an essential part of state efforts to protect policyholders through regulation. When an insurer enters liquidation, conferring a favored priority on the claims of policyholders is Ohio's last resort in its effort to make sure that insurance companies live up to their obligations.[10]

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[10] Many jurisdictions that grant policyholders priority have decided that claims by insurance companies against insolvent reinsurers do not qualify as claims of policyholders, reaffirming the principle that the purpose of the priority and other insolvency regulatory provisions is to protect the policyholding public. As the Virginia Supreme Court put it,

> The average individual property owner is uninformed as to many of the details of the business [of insurance], and, for this and other reasons, is not in a position to judge of the solvency of any particular company. The danger of imposition upon its citizens by irresponsible companies is one of the controlling reasons for the enactment of such a provision.

Shepard v. Virginia State Ins. Co., 120 Va. 383, 91 S.E. 140, 141 (1917). *See also Cunningham v. Republic Ins. Co.*, 94 S.W.2d 140, 142-43 (Tex. Civ. App. 1936) (quoting *Shepard*); *Aetna Casualty & Surety Co. v. Int'l Reinsurance Corp.*, 117 N.J. Eq. 190, 175 A. 114, 121 (1934); *Foremost Life Ins. Co. v. Dep't of Ins.*, 274 Ind. 181, 409 N.E.2d 1092, 1097 (1980); *In re Liquidations of Reserve Ins. Co.*, 122 Ill. 2d 555, 524 N.E.2d 538 (1988); *Van Schaick v. General Indemnity Corp.*, 274 N.Y. 510, 10 N.E.2d 523 (1937); *State v. Beacon Ins. Co.*, 87 N.C. App. 72, 359 S.E.2d 508, 511 (1987) (purpose of policyholder priority is to protect "consumer, who must rely upon the industry for protection, and yet who clearly does not have equal knowledge or resources at his disposal in his dealings with the business of insurance"); *Neff v. Cherokee Ins. Co.*, 704 S.W.2d 1 (Tenn. 1986).

B. McCarran-Ferguson Recognizes the Traditional Authority of the States to Regulate Insurer Insolvencies.

The United States argues that McCarran-Ferguson has a "narrow reach," extending only to state regulation of policy formation and interpretation. Pet. Br. 13, 18-19. To the contrary, at the time McCarran-Ferguson was enacted, the States had long exercised broad regulatory authority over the "business of insurance," including insurer insolvencies.

The regulation of insurance "has traditionally been under the control of the states." *SEC v. Variable Annuity Life Ins. Co.*, 359 U.S. 65, 69 (1959); *see also Paul v. Virginia*, 75 U.S. (8 Wall.) 168, 183 (1868), ("[i]ssuing a policy of insurance is not a transaction of commerce" within the Commerce Clause). For the seventy-five years after *Paul*, that case was understood to have "nullif[ied] federal authority" over the insurance business, making regulation of insurance a state matter. *Prudential Ins. Co. v. Benjamin*, 328 U.S. 408, 414 (1946). *Paul* re-

mained the law until it was overruled in *United States v. South-Eastern Underwriters Ass'n*, 322 U.S. 533 (1944).[11]

[11] Relying on *United States v. Knott*, 298 U.S. 544 (1936), the United States argues that McCarran-Ferguson could not have given States the right to prioritize policyholders' claims ahead of those of the United States because the States had no such right prior to *South-Eastern Underwriters*. Pet. Br. 24-25. In *Knott*, the United States demanded payment of judgments it recovered on appearance bonds, asserting that it was entitled to priority. While this Court concluded that the United States' claim was "entitled to priority" over the claims of in-state creditors, 298 U.S. at 548, there is no indication that the in-state creditors were policyholders of the type given priority by the Ohio statute or that the Florida insolvency statute gave priority to policyholders in a manner similar to the Ohio statute. At most, *Knott* stands for the entirely unremarkable proposition that, in paying the claims of a class of creditors, a State cannot give priority to other creditors over the United States solely on the basis of its governmental status. Moreover, no issue of whether a statute could give priority to the claims of policyholders over any claim of the United States was present.

The United States also relies on cases from New York, New Jersey and Louisiana to argue that the States had, prior to *South-Eastern Underwriters*, acknowledged the preemptive force of the federal superpriority statute in insurer insolvency proceedings. *See* Pet. Br. 24 n.11. Neither the New Jersey case, *Fred L. Emmons, Inc. v. Union Indemnity Co.*, 175 A. 141 (N.J. 1934), nor the New York cases, *In re Casualty Co. of America*, 196 A.D. 175, 176-77 (1st Dep't), *aff'd*, 232 N.Y. 559, 561 (1921), and *People v. Metropolitan Surety Co.*, 161 N.Y.S. 616 (1916), contain any indication that claims of policyholders were involved. Quite remarkably, the United States also relies on *Conway v. Imperial Life Ins. Co.*, 21 So.2d 151 (La. 1945). In *Conway*, the issue of the preemptive effect of the federal superpriority statute on policyholders' claims was squarely presented. The Louisiana Supreme Court held, however, that a state law requiring the insurer to deposit securities with the State Treasurer "for the benefit and protection of and as security for the policyholders" created a trust and that "the claim of the policyholders to the funds in question must prevail over the claim of the United States." 21 So.2d at 153.

Rightly or wrongly, Congress considered the *South-Eastern* decision " 'precedent-smashing.' " *Prudential*, 328 U.S. at 414 (quoting S. Rep. No. 1112, 78th Cong., 2d Sess. at 2). Faced with the possibility that *South-Eastern* had invalidated the entire existing system of state regulation, Congress enacted the McCarran-Ferguson Act for one purpose: " 'to broadly . . . give support to the existing and future state systems for regulating and taxing the business of insurance.' " *SEC v. National Securities, Inc.*, 393 U.S. 453, 458 (1969) (quoting *Prudential*, 328 U.S. at 429). Congress manifested its intent "to throw the whole weight of its power behind the state systems," *Prudential*, 328 U.S. at 430, as evidenced by McCarran-Ferguson's "Declaration of Policy" that "the continued regulation and taxation by the several States of the business of insurance is in the public interest." 15 U.S.C. § 1011.

To be sure, McCarran-Ferguson did not exempt every activity of insurance companies from federal regulation. This Court, however, has made clear that Congress intended that the core of insurance regulation—regulation of the insurer-policyholder relationship—remain securely within the States' ambit:

> Congress was concerned with the type of state regulation that centers around the contract of insurance, the transaction which *Paul v. Virginia* held was not 'commerce.' The relationship between insurer and insured, the type of policy which could be issued, its *reliability*, interpreta-

tion, and *enforcement*—these were the core of the 'business of insurance.' Undoubtedly, other activities of insurance companies relate so closely to their status as reliable insurers that they too must be placed in the same class. But whatever the exact scope of the statutory term, it is clear where the focus was—it was on *the relationship between the insurance company and the policyholder.*

SEC v. National Securities, Inc., 393 U.S. at 460 (emphasis added). Accordingly, state laws "aimed at protecting or regulating this relationship, *directly or indirectly*, are laws regulating the 'business of insurance.'" *Id.* (emphasis added).

State laws regulating insurer solvency plainly go to "the core of the 'business of insurance'" as it was understood at the time McCarran-Ferguson was enacted. *See, e.g., Robertson v. California*, 328 U.S. 440, 459-62 (1946) (upholding state authority to enforce minimum asset requirements for insurers). As *Robertson* noted,

> [*South-Eastern*] did not wipe out the experience of the states in the regulation of the business of insurance or its effects for the continued validity of that regulation. Much of this was concerned with the activities of so-called foreign insurance companies and, in particular, *with requirements designed to secure minimum guaranties of solvency and ability to pay claims as they mature.*

Robertson, 328 U.S. at 457-58 (emphasis added).[12] If anything is critical to the "reliability" of insurance policies and the issuing companies' "status as reliable insurers," *National Securities*, 393 U.S. at 460, it is the companies' solvency. State regulation directed at ensuring solvency is quintessential regulation of "the relationship between the insurance company and the policyholder," *id.*, because it is designed to uphold the policyholder's expectations.

[12] Although the case was not decided under McCarran-Ferguson because the criminal conviction under review took place before passage of the Act, the Court noted that "the McCarran Act, if applied, would dictate the same result." *Robertson*, 328 U.S. at 462.

Just as the prevention of insurer insolvency was within the States' domain when McCarran-Ferguson was enacted, so too was the regulation of insurer insolvency. *See, e.g., United States v. Knott*, 298 U.S. 544 (1936); *In re Union Guar. & Mortgage Co.*, 75 F.2d 984 (2d Cir. 1935) (L. Hand, Swan, and A. Hand, JJ.); *In re Peoria Life Ins. Co.*, 75 F.2d 777 (7th Cir.), *cert. denied*, 296 U.S. 594 (1935). Congress so legislated in 1910, when it amended the Bankruptcy Act of 1898[13] to specify that insurance companies could not liquidate under federal law. *See* Act of June 25, 1910, ch. 412, 36 Stat. 839.[14] Congress' purpose was

> to leave to local winding up statutes the liquidation of such companies; that, since the states commonly kept supervision over them during their lives, it was reasonable that they should take charge on their demise.

Union Guar. & Mortgage Co., 75 F.2d at 984. Congress thus expressly recognized the tradition of state regulation of insurer insolvency.

[13] Act of July 1, 1898, ch. 541, 30 Stat. 544.

[14] Congress reenacted the insurance company exclusion in 1938. *See* Chandler Act, Act of June 22, 1938, ch. 575, 52 Stat. 845 (1938).

In "throw[ing] the whole weight of its power behind the state systems," the McCarran-Ferguson Congress "must have had full knowledge of the nation-wide existence of state systems of regulation and taxation." *Prudential*, 328 U.S. at 430. Protection of policyholders' interests in liquidations is just as much within the "core of the 'business of insurance,'" *National Securities*, 393 U.S. at 460, as insolvency prevention. *See, e.g., Conway v. Imperial Life Ins. Co.*, 21 So.2d 151, 153 (La. 1945). Under Ohio's priority statute, liquidation proceedings are principally concerned with the "reliability" and "enforcement" of the promises made by insurers to policyholders. *National Securities*, 393 U.S. at 460. Enforcement of those promises goes directly to "the relationship between the insurance company and the policyholder." *Id.* The McCarran-Ferguson Congress clearly viewed those enforcement mechanisms as regulation of the "business of insurance."

C. Under *National Securities*, Ohio's Statute Regulates the "Business of Insurance"; the *Pireno* Criteria are Inapplicable Here Because They were Devised to Construe McCarran-Ferguson's Narrow Antitrust Exemption.

This Court has only once considered whether a particular state statute was "enacted . . . for the purpose of regulating the business of insurance" under McCarran-Ferguson. *See National Securities*, 393 U.S. at 453. *National Securities* involved whether two distinct provisions of Arizona law were preempted by the federal securities laws or were permissible state regulations of the business of insurance. The first provision required that the Arizona Director of Insurance approve a merger involving a state insurer only if it was fair to the company's

stockholders and not otherwise contrary to law. The Court held that the law did not regulate the "business of insurance," noting that "[t]he crucial point is that here the State has focused its attention on stockholder protection; it is not attempting to secure the interests of those purchasing policies." *Id.* at 460.

The second provision required the Director to find that the transaction "would not 'substantially reduce the security of and service to be rendered to policyholders' before he gives his approval." *Id.* at 462 (quoting Ariz. Rev. Stat. Ann. § 20-731(B)(3) (Supp. 1969)). This Court readily concluded that the statute "clearly relate[d] to the 'business of insurance.'" *Id.* This Court thus held that state regulation of the "security" of insurance—that is, insurer solvency regulation—constitutes regulation of the "business of insurance."

Ohio's priority statute is, of course, an "attempt[] to secure the interests of those purchasing policies." *Id.* at 460. Moreover, the provision is clearly aimed at protecting "the security of and service to be rendered to policyholders." *Id.* at 462. *National Securities*' analysis thus fully supports the conclusion that the Ohio statute regulates the "business of insurance."

Ignoring the manifest purpose of subsection 2(a) of McCarran-Ferguson to preserve the States' broad regulatory authority, the United States principally relies on *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119 (1982), and *Group Life & Health Ins. v. Royal Drug*, 440 U.S. 205 (1979), to argue that Ohio's priority statute does not regulate the "business of insurance." The United States' reliance on these two cases, which interpret McCarran-Ferguson's an-

titrust exemption of subsection 2(b), 15 U.S.C. § 1012 (b), is misplaced.

It is obvious that both Congress' grant to the States of the authority to regulate insurers and the antitrust exemption use the same "business of insurance" language.[15] These two provisions of McCarran-Ferguson serve entirely distinct purposes, however, as this Court recognized in *Royal Drug*:

> There is no question that the *primary* purpose of the McCarran-Ferguson Act was to preserve state regulation of the activities of insurance companies, as it existed before the *South-Eastern Underwriters* case. . . . The McCarran-Ferguson Act operates to assure that the States are free to regulate insurance companies without fear of Commerce Clause attack. . . . [T]he quite different *secondary* purpose of the McCarran-Ferguson Act [is] to give insurance companies only a limited exemption from the antitrust laws.

440 U.S. at 218 n. 18 (emphasis in original). Given the distinct purpose of each provision, it does not follow that this Court's identification in both *Pireno* and *Royal Drug* of three criteria for "determining whether *a particular practice* is part of the 'business of insurance' *exempted from the antitrust laws by 2(b)*,"

[15] The full text of the antitrust exemption reads:

> . . . *Provided*, That after June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended, shall be applicable to the business of insurance to the extent that such business is not regulated by State Law.

15 U.S.C. § 1012(b).

Pireno, 458 U.S. at 129 (emphasis added), controls the very different question of whether a State has regulated the "business of insurance." As *Pireno* itself states, its three criteria are relevant in determining the scope of the antitrust exemption, an exemption which is to be narrowly construed. *Id.* at 126; *see also FMC v. Seatrain*, 411 U.S. 726, 733 (1973). *Pireno* does not even purport to establish a test applicable for determining whether a state law regulates the "business of insurance." *See generally* 458 U.S. at 126-30.

Indeed, *Pireno's* three criteria—"*first*, whether the practice has the effect of transferring or spreading a policyholder's risk; *second*, whether the practice is an integral part of the policy relationship between the insurer and the insured; and *third*, whether the practice is limited to entities within the insurance industry[,]" 458 U.S. at 129 (emphasis in original),—are simply inapplicable beyond the specific "practices" challenged in the antitrust context.[16] The focus of both *Pireno* and *Royal Drug* is on whether an insurer's particular business practice constitutes the "business of insurance" consistent with the narrow purpose of the antitrust exemption to allow for "cooperative

[16] To be sure, this Court has used the *Pireno* criteria to construe ERISA's clause saving from preemption any state law "which regulates insurance." *See, e.g., Metropolitan Life Ins. Co. v. Mass.*, 471 U.S. 724, 740 (1985) (state minimum benefit law "regulate[d] insurance" and was not preempted by ERISA § 514(b)(2)). The Court's reliance on the *Pireno* criteria was but one of several independent grounds offered in support of the result. Of note, this Court has never applied the *Pireno* criteria outside of the antitrust context to hold, as the United States asks the Court to do here, that a state law did not regulate the "business of insurance."

ratemaking" on the part of insurers. *Royal Drug*, 440 U.S. at 221.[17]

Of equal significance here, *Royal Drug* makes clear that at "the core of the business of insurance" is the insurer's payment of the policyholder's claims. As this Court noted in rejecting the insurer's argument that the pharmacy reimbursement agreement constituted the "business of insurance":

> The fallacy of the petitioners' position is that they confuse the obligations of [the insurer] under its insurance policies, which insure against the risk that policyholders will be unable to pay for prescription drugs during the period of coverage, and the agreements between [the insurer] and the participating pharmacies, which serve only to minimize the costs [the insurer] incurs in fulfilling its underwriting obligations. The benefit promised to [the] policyholders is that their premiums will cover the cost of prescription drugs except for a $2 charge for each prescription. *So long as that promise is kept*, policyholders are basically unconcerned with arrangements made between [the insurers] and participating pharmacies.

Royal Drug, 440 U.S. at 214 (footnotes omitted; emphasis added); *see also Pireno*, 458 U.S. at 132 (the

[17] Of note, neither *Pireno* nor *Royal Drug* involved "the core of the 'business of insurance,'" *Pireno*, 458 U.S. at 128 (quoting *National Securities*, 393 U.S. at 460), that is, "the 'relationship between insurer and insured, the type of policy which could be issued, its *reliability*, interpretation, and *enforcement*." *Id.* (emphasis added). Neither the reimbursement agreement between the insurer and pharmacies at issue in *Royal Drug*, *see* 440 U.S. at 209, nor the peer review procedre at issue in *Pireno*, *see* 458 U.S. at 122-23, directly involve the promise of an insurer to pay claims.

"only concern [of the policyholder] is *whether* his claim is paid, not *why* it is paid") (emphasis in orignal). Both *Royal Drug* and *Pireno* make clear that the payment of the policyholder's claims is at the "core of the 'business of insurance.'" *Pireno*, 458 U.S. at 128; *Royal Drug*, 440 U.S. at 215-216 (both quoting *National Securities*, 393 U.S. at 460). Because the *Pireno* criteria are concerned solely with the *insurer's* understanding of the "business of insurance," and disregard the perspective of the *policyholder*, it is particularly inappropriate to apply them here.

In short, both *Pireno* and *Royal Drug* make clear that their three criteria are inapplicable outside of the antitrust context. The United States' insistence that these criteria apply in this case ignores the fundamental purpose of insurance, the broad authority Congress gave the States to regulate the "business of insurance" and the limited scope of McCarran-Ferguson's antitrust exemption.[18]

[18] The United States also relies on dictum in *Royal Drug* which states that statutes regulating "such diverse aspects of . . . plans as . . . when they could liquidate or merge" do not regulate the business of insurance. *See Royal Drug*, 440 U.S. at 230 n.38; *see also* Pet. Brief at 15. The United States' argument is contradicted by this Court's holding in *National Securities* that a state law requiring the Director of Insurance to find that a merger "would not 'substantially reduce the security of and service to be rendered to policyholders' before . . . giv[ing] his approval," was a valid state regulation of the "business of insurance." 393 U.S. at 462. The United States' position is further undercut by *Royal Drug's* own acknowledgment that it is the insurer's promise of payment to the policyholder that is at the "core of the 'business of insurance.'" *See* 440 U.S. at 211-17.

CONCLUSION

The judgment of the court of appeals should be affirmed.

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